IN THE

# Supreme Court of the United States

OCTOBER TERM, 1951.

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**No. 525.**

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ALLEGHANY CORPORATION,

Petitioner,

*against*

GROUP OF INSTITUTIONAL INVESTORS HOLDING FIRST AND REFUNDING MORTGAGE 5% BONDS OF MISSOURI PACIFIC RAILROAD COMPANY, *et al.*,

Respondents.

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## BRIEF FOR RESPONDENT MANUFACTURERS TRUST COMPANY, AS CORPORATE TRUSTEE UNDER THE FIRST AND REFUNDING MORTGAGE OF MISSOURI PACIFIC RAILROAD COMPANY, IN OPPOSITION.

### Opinions Below.

The opinion of the District Court is reported at 93 F. Supp. 832 (E. D. Mo. 1950). The opinion of the Court of Appeals for the Eighth Circuit (C. R. 14-36)* is reported at 191 F. 2d 265 (8 Cir. 1951).

The Fourth and Fifth Supplemental Reports of the Interstate Commerce Commission (D. R. 28469, 28640) are reported at 275 I. C. C. 59, 203. The Plan of Reorganization is at D. R. 28689-760.

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* A list of abbreviations and references used in this brief is on page iii, *supra*.

## Jurisdiction.

The jurisdictional requisites are set forth in the Petition.

## Question Presented.

This Petition for Writ of Certiorari is one of five* now pending before this Court requesting a review of the decision of the United States Court of Appeals for the Eighth Circuit affirming the approval of the Plan of Reorganization of the Missouri Pacific Railroad System. Certiorari has already been denied in No. 415, *James B. Morris, et al.* v. *Group of Institutional Investors, et al.*, and in No. 416, *State of Texas* v. *Group of Institutional Investors etc.* The question raised by this petition is:

> Whether the District Court performed the duties imposed upon it by Section 77(e) of the Bankruptcy Act, 11 U.S.C. §205(e), when it approved the Plan of Reorganization for the Missouri Pacific Railroad System certified to it by the Interstate Commerce Commission.

While this brief is specifically addressed to the Petition of Alleghany Corporation (No. 525), respondent will not repeat its argument on the above question in its other briefs, and respectfully requests this Court to consider the argument herein in connection with the other petitions for writ of certiorari which present this question.

## Statement.

The history of these proceedings is set forth in paragraphs 1-6 of Petitioner's "Summary Statement" (Petition, pp. 3-6).

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* October Term 1951, Nos. 524-528.

In fixing a maximum capitalization of $612,000,000 for the System the Commission said (D. R. 28553):

> "There have been stated herein the elements of physical value of the debtors as determined by our Bureau of Valuation, their assets and liabilities as reported by their trustee, the record of their earnings, and the book and estimated values of their investments in affiliated companies and 'other investments.' All of these elements are important to consider in determining a permissible capitalization for the reorganized company. *The greatest weight should be given to the past and prospective earnings of the system in order that ample coverage of fixed interest may be assured in years of relatively lean earnings, and all interest as well as a return to stockholders be reasonably assured in more favorable years.* In considering past earnings the record of the debtor over a considerable period is more convincing of future performance than for a few years when special conditions may temporarily inflate or depress its operating results. As we have heretofore stated, the abnormal earnings of the war years cannot be considered as a criterion of the earnings which may be expected to be realized in the future so far as can be foreseen at the present time." [Emphasis supplied]

The Commission found that the total of annual interest and dividend requirements will amount to approximately 4½% of the new capitalization (D. R. 28554), and that:

> "Upon such basis, a capitalization of the average annual system earnings of $15,455,508 for the 5-year period 1937-1941 immediately preceding the entry of the United States into the world war produces $343,455,733, a capitalization of the average annual earnings of $42,854,927 for the period 1942-1948, which includes the extraordinary earnings of the

> war years, produces $952,331,711, a similar capitalization of the average annual system earnings of $31,438,502 for the 12-year period, 1937-1948, results in $698,633,378, and a capitalization of the trustee's normal-year forecast of $25,450,000, as herein adjusted, amounts to $565,555,555. Capitalization of the average of $34,656,736 for the 3 postwar years, 1946-1948, produces $770,149,688'' (D.R. 28554).

The Commission found that "upon a consideration of the entire record, including past, current, and estimated future earnings, the evidence of economic experts as to the future business prospects of the United States generally and of the Missouri Pacific territory specifically, and of other pertinent factors, . . . that a reasonable future normal year's earnings available for payment of interest after income taxes, will, so far as can be foreseen at this time, approximate $19,000,000 for the Missouri Pacific, $4,700,000 for the New Orleans, $1,750,000 for the International, and $25,450,000 for the system" (D. R. 28545). The factors which the Commission took into account in determining a future normal year's earnings are stated in its Fourth Supplemental Report at D. R. 28526-546. In its Fifth Supplemental Report the Commission pointed out that (D. R. 28655):

> "* * * our determinations of a normal year's earnings for each of the three principal debtors and for the system are not the result of mere additions of prospective earnings from citrous and chemical traffic to the trustee's normal-year forecasts. We considered many other factors as indicated in our report, including the general industrial growth of the communities served, the improvements made to the physical properties of the debtors which have resulted in more economical operation, etc., as well as certain adverse factors, which we enumerated."

In determining the new capital structure the Commission found that within the System capitalization of $612,000,000 the securities to be issued were of such kind and amounts "as to insure coverage of fixed interest in years of least favorable earnings and ample coverage of all interest charges together with a fair return to stockholders during periods of good earnings" (D. R. 28564). Thus, in any year when earnings of $25,450,000 should be realized, and before deductions for sinking fund payments, these earnings would cover the fixed and contingent interest, the dividend on the preferred stock, and most of the dividend on the class A common stock, although there would be nothing for the class B common stock (D. R. 28566).

## Argument.

Alleghany's case rests on the proposition that the Commission and the Courts below gave too much weight to the depression years and not enough weight to the inflationary years in determining the maximum capitalization for the Missouri Pacific System. This Court is asked in effect, to examine *de novo* the twelve volumes of the record and the more than 1,000 exhibits that have accumulated in the 18-year history of this reorganization proceeding, and to reach conclusions contrary to those of the Commission and the two Courts below. Again and again this Court has said it will not conduct such a re-examination "in the absence of a very exceptional showing of error." See *Comstock* v. *Group of Institutional Investors etc.*, 335 U. S. 211, 214 (1948); *United States* v. *O'Donnell*, 303 U. S. 501, 508 (1938); *Texas & New Orleans Railroad Company* v. *Brotherhood of Railway & Steamship Clerks*, 281 U. S. 548, 558 (1930).

The Commission's conclusion that the maximum capitalization for the System should not exceed $612,000,000 is supported by material evidence and was reached by the application of the proper statutory standards. The District Court carefully performed the function required of it by the Statute as construed by this Court in *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448 (1943) and *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Company*, 318 U. S. 523 (1943). There is no important question of Federal law requiring decision by this Court, but only a question of the Commission's judgment. As this Court said in *Timken Roller Bearing Co.* v. *United States*, 341 U. S. 593, 596-97 (1951), this "is actually only a dispute as to the proper inferences to be drawn from the evidence in the record; in effect, it is an invitation for us to try the case *de novo*. This Court must decline such an invitation . . ."

## I.

**In approving the plan of reorganization the District Court correctly performed the function assigned to it by Section 77.**

After the decisions by the Court in the *Milwaukee* and *Western Pacific* cases *(supra)*, the original Plan for the reorganization of the Missouri Pacific System was returned by the Court of Appeals to the District Court to determine whether "in view of changed conditions and the decisions of the Supreme Court under date of March 15, 1943, in the cases involving the reorganization of the Western Pacific and the Chicago, Milwaukee, St. Paul & Pacific Railroad Company," the Plan should be referred back to the Interstate Commerce Commission for further consideration (1946

R. 48), and the District Court referred it back to the Commission (1946 R. 126-27).

In approving the present Plan, the District Court found that the Commission's determination of value and capitalization had been reached in accordance with legal standards and was supported by material evidence. Petitioner's contention appears to be that there is other evidence in the record from which different conclusions might have been drawn. But it would have been a clear violation of the limited role assigned to the District Court, with respect to valuation and capitalization, for it to reject the findings by the Commission based upon 63 pages of detailed discussion of the elements considered in arriving at the new capitalization (D. R. 28501-564).

The Plan is not, as Petitioner suggests, based on a return to the conditions which existed in the railroad industry in the depths of the depression. The System earnings available for payment of interest from 1932 to 1940 were as follows:*

| Year | Earnings Available for Interest |
|---|---|
| 1932 | $11,322,497 |
| 1933 | 10,178,938 |
| 1934 | 10,135,163 |
| 1935 | 5,998,523 |
| 1936 | 14,152,964 |
| 1937 | 15,456,122 |
| 1938 | 7,621,035 |
| 1939 | 10,097,423 |
| 1940 | 13,495,717 |

* Figures for the years 1932 to 1936 are in the Commission's Original Report, 1941 R. 333; 239 I. C. C. 33. Figures for the years 1937 to 1940 are in the Commission's Fourth Supplemental Report, D. R. 28542.

Thus the Commission's forecast for a future normal year's earnings is at least $14,000,000 higher than the average earnings during those depression years, and $10,000,000 higher than in any of those years.

Unlike the Petitioner, the Commission noted "certain adverse factors" (D. R. 28655) which might affect the System's earning power. Among these are "the constantly increasing cost factor as related to increasing traffic volume" (D. R. 28545), and the tendency of "traffic volume and revenue to decrease in a greater degree proportionately than will expenses" in the event of an industrial contraction (D. R. 28542).

Certainly, there was no basis for the District Court to upset the maximum capitalization arrived at by the Commission after considering all these factors.* Indeed, this very Petitioner joined in sponsoring a plan before the Commission which provided a capitalization of $619,000,000 for the System, only $7,000,000 more than the amount finally approved by the Commission (D. R. 28480, 28483; 1951 R. 184).

Petitioner attacks the Commission's capitalization of the New Orleans considered as a separate entity (Petition, pp. 46-49). The determination of separate capitalizations for each of the three principal Debtors was solely for the purpose of allocation of new securities to their respective

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* Petitioner repeatedly refers to events that have occurred since the approval of the Plan of Reorganization and which are not included in this record. The Interstate Commerce Commission, acting under 11 U. S. C. §208(a)(1) is now considering whether any "changes, facts and developments" have occurred since the approval of the Plan which were not provided for in the Plan and which make it necessary for the Commission to re-examine it. Respondent does not believe that any such changes have occurred, but it submits that the proper forum for determination of that question is the Interstate Commerce Commission and that this Court's action should be based on the evidence in the record before it.

security holders. The System capitalization was arrived at independently, and before any attempt was made to establish the separate capitalizations (D. R. 28556). As Petitioner does not participate at all in the reorganized company, the allocation of securities, and therefore the capitalization of the Debtors separately, is irrelevant to it.

## II.

### There is no conflict of decision.

In final analysis, Petitioner's complaint is that the capitalization of the System, as determined by the Commission, is not sufficient to leave any equity for the old common stock. But neither the Congress nor this Court has declared that the new capitalization of reorganized railroads shall be fixed in such amount as will enable all the old securities to participate. To the contrary, this Court has held "that the elimination of the claims of stockholders and creditors which are valueless from participation is in accordance with valid provisions of §77(e)." *Ecker* v. *Western Pacific Railroad Corp.*, 318 U. S. 448, 475-76 (1943). Indeed, this Court has said that if it is established that there is no "reasonable probability that the earning power of the road will be sufficient to pay prior claims of interest and principal and leave some surplus for the service of the stock" then "the inclusion of the stock would violate the full priority rule . . . incorporated in §77(e)(1)." *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, 318 U. S. 515, 541-42 (1943); *Reconstruction Finance Corporation* v. *Denver & Rio Grande Western Railroad Co.*, 328 U. S. 495, 509 (1946).

In every reorganization there is usually a scaling down in amount of capitalization. In equity, the secured senior bondholders should suffer least; the most junior stockholders the most. As this Court said in the *Western Pacific* case, "senior bondholders first receive securities of a worth sufficient to cover their face and interest before junior claims receive anything" (318 U. S. at p. 483).

Lastly, Petitioner claims that the Commission should have granted larger rate increases which would have produced larger earnings. The case now before this Court is not a rate making proceeding. The "question in a valuation for rate making is how much a utility will be allowed to earn. The basic question in a valuation for reorganization purposes is how much the enterprise in all probability can earn" (*Milwaukee* case, 318 U. S. at p. 540). No factual basis has been established as to whether higher rates would result in greater net revenue rather than divert traffic to other competitive transportation lines such as trucks, pipe lines and water carriers. In any event, this is not the proper forum to initiate questions on rate structure, the wisdom of furnishing necessary passenger service or operational problems generally.

## Conclusion.

For the foregoing reasons, it is respectfully submitted that this Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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